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RUEHCI/AMCONSUL KOLKATA 0793
RUEHLH/AMCONSUL LAHORE 4115
RUEHBI/AMCONSUL MUMBAI 0502
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UNCLAS SECTION 01 OF 03 NEW DELHI 004076

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E.O. 12958: N/A
TAGS: [BTIO](#) [EAGR](#) [ECON](#) [EINV](#) [IN](#)
SUBJECT: INDIAN RETAIL ENVIRONMENT GROWS MURKIER

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SUMMARY

11. (SBU) The developments of the past two weeks in Uttar Pradesh (UP) and Kerala have further complicated an already volatile environment for retail investors. The UP government ordered several newly opened retail outlets closed following violent protests by traders, and Kerala is pushing for a revision of a law that will tightly restrict retail investment in the state. India's central government has not yet taken action in defense of big retailers, but Minister for Agriculture, Food and Consumer Affairs Pawar said publicly that permanent bans on retail operation might violate the constitution. West Bengal has promised to protect retail outlets, and Punjab has said that it welcomes retail investors but will not give them free land. End summary.

BACKGROUND

12. (U) This year has seen several attacks on organized retail in India. In Ranchi, Jharkand, groups of armed street vendors attacked three Reliance Fresh stores on May 12. On May 24, another such attack occurred in Indore, Madhya Pradesh, and then on August 18, the Forward Bloc organized a raid on a Reliance Fresh store still under construction in Kolkata. Playing on Gandhi's "Quit India Day," the umbrella organization India FDI Watch (www.indiafdiwatch.org), which is affiliated with an American anti-globalization NGO, coordinated "Quit Retail Day" rallies on August 9 in cities throughout India. Protestors chanted slogans against organized retail in general and foreign investment in retail in particular. Wal-Mart made for a popular target after signing a deal with Bharti earlier that week to open as many as 15 wholesale outlets in India over the next seven years.

13. (U) While the small retailers and supply-chain middlemen who stand to lose business to organized retail have found a number of outspoken advocates, retail investors have received some quiet support from high-end produce farmers, who get higher return on their crops from organized retailers. Farmers in West Bengal put up a roadblock to protest attacks on Reliance Fresh outlets, and UP farmers have demonstrated against the closure of Reliance Fresh stores in their state (see paragraphs 4 and 5). (Comment: We expect retail chains to get support especially from vegetable farmers located 250

kilometers or less from an outlet, the radius within which Reliance has said it will purchase locally available produce, as well as from middle-class consumers looking for lower grocery prices. End comment.)

MAYAWATI PUTS HER FOOT DOWN...SORT OF

14. (U) Despite the protests and attacks, ambitious retail-development plans for India marched ahead until big retailers suffered a significant setback in UP on August 23. Chief Minister Mayawati ordered organized supermarket retailers in the state to close shop, purportedly to restore peace following the ransacking on August 22 of new Reliance Fresh and Spencer,s outlets in Lucknow and Varanasi. The attacks were part of protests organized by the opposition Samajwadi Party. The Chief Minister subsequently formed a five-member committee, headed by Cabinet Secretary Shashank Shekhar Singh, to evaluate the feasibility and impact of organized retail in UP and report back within a month.

15. (U) The UP government stated that the order applied only to stand-alone outlets, not to those located in malls. It was unclear, though, whether the order applied throughout the state or just to Lucknow and Varanasi. Densely populated Noida and Ghaziabad raised particular concern. They lie within UP borders, but they are essentially suburbs of New Delhi and offer flourishing retail markets. Illustrating the confusion, Reliance closed its doors in Noida at noon on August 24 but reopened them four hours later, and Reliance stores in each city have been operating since on an ad hoc basis.

16. (U) Meanwhile, Spencer,s outlets have remained open even in Lucknow. Vice Chairman Sanjiv Goenka of RPG, which owns Spencer,s, indicated that the chain will not close unless

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the company receives an official communique from the government. Goenka denied that Spencer,s outlets were ever attacked by protestors, suggesting that the rumor might have been spawned by competitors.

17. (U) The Federation of Indian Chambers of Commerce and Industry (FICCI), the Confederation of Indian Industry (CII), and the Associated Chambers of Commerce and Industry in India (ASSOCHAM) have all spoken out against Mayawati,s decision, arguing that the closures are bad for consumers, companies, and farmers, who stand to get higher prices for their crops by selling more directly to large retailers. Union Minister for Food and Consumer Affairs Sharad Pawar has stated that while preservation of law and order is within the purview state governments, he does not see how UP could legally make the closures permanent.

18. (U) Mayawati, however, insisted that the closure order would remain in effect until she receives a report from her committee, which will look at issues of location, licensing, health, and of course law and order.

19. (U) On the same day the closures were ordered, Mayawati scrapped the agricultural reforms she had announced on August 13. The abandoned policy would have allowed farmers to contract with companies whose net worth exceeded INR 5 billion (USD 122 million). Mayawati intended the policy to encourage large retailers to invest in UP,s rural areas, but she altered course after a state-sponsored survey showed that 60 percent of farmers opposed the policy, another hit to retailers, investment opportunities in the state. The UP government did not offer any detail on which parts of the policy farmers opposed, the reasons for their opposition, or the government's methodology in conducting the survey.

INVESTORS SURVEY THE LANDSCAPE

¶10. (SBU) Reliance Industries has plans to invest USD 6 billion in organized retail in India, but they have now announced that they will slow development in the states of UP, Kerala, and West Bengal, which they now perceive to be problem areas. A Reliance contact told Emboff that the company will respond to recent developments by proceeding cautiously with their plans, with a constant eye towards law-and-order concerns, and fight bans or problematic legislation in the courts, if necessary.

¶11. (U) Kerala,s communist government has justified Reliance,s concern with a proposed reinterpretation of the Essential Commodities Act that would bar the entry of organized retailers into rural areas and limit operations in cities. C. Divakaran, Kerala,s Minister for Food and Civil Supplies, anticipates that a new state-level interpretation will be formalized by the end of the year. Though the Financial Express reported that the central government asked both Kerala and UP for an explanation of their policies, noting possible violation of the Indian constitution, Divakaran indicated that Kerala,s government has received no such request. Divakaran,s Ministry is also planning to upgrade existing "ration shops" to help them compete with new retail outlets.

¶12. (U) West Bengal's government, also communist, has taken a different stance. On August 26, there were attacks reported on the same Reliance Fresh outlet in Kolkata that was attacked on August 18. Rather than ordering the closure of retail outlets to restore peace, Chief Minister Buddhadeb offered "full police protection and security to all Reliance installations in West Bengal," per The Economic Times.

¶13. (U) The press has reported that Punjab might be the next state to take action against organized retail, but the working president of Punjab,s ruling Shiromani Akali Dal (SAD), Sukhbir Badal, stated on August 28 that while SAD opposes the concessions offered by the Congress Party leaders who preceded his administration, the party supports investment of any sort in the state and would not discourage large retailers.

¶14. (SBU) Indeed, a contact at Wal-Mart told Emboff that Punjab would be home to the first Wal-Mart-Bharti cash-and-carry outlet, both because of the friendly

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government and because it is the home of Bharti head Sunil Bharti Mittal. The contact added that Wal-Mart considers press coverage of the Bharti pact "not too bad" so far, but Wal-Mart is paying close attention to the retail environment, as it will affect Wal-Mart's front-end partners.

COMMENT

¶14. (SBU) Whatever comes of the situation in UP, these developments are likely to damage investor confidence in the state. Mayawati,s Bahujan Samaj Party seems unwilling to resist pressure from special-interest groups advocating for small retailers, no matter the damage the investment climate might incur or the opportunities farmers might lose. We expect that Mayawati will at least make allowances for organized retail in Noida and Ghaziabad, but if UP,s committee yields anti-retail policy advice, intercession by the central government on constitutional grounds would be helpful in protecting the interests of retail investors. That said, given the central government's tenuous hold on power and the possibility of general elections in the near future, it is doubtful that the Center will offer any strong response on such a controversial subject.

¶15. (SBU) Buddhadeb,s actions are no guarantee of support down the road for foreign companies. West Bengal's Chief Minister has a record of soliciting foreign investment in West Bengal, but the traditionally protectionist attitude of

Indian communists may still prevail in the state when the delicate issue of FDI in retail comes into play.

¶16. (SBU) The protests to this point are no greater than one would expect with such a dramatic potential shift in the economic landscape, and they are largely occurring in less progressive regions, whereas in New Delhi, Maharashtra, Andhra Pradesh, and other progressive areas, people generally recognize the benefits of organized retail and welcome its development. It is also important to note that there are two distinct drivers behind these protests. One is a fundamental opposition to organized retail, as in the cases of some of the isolated attacks by traders and the August 9 protests orchestrated by an NGO laying the groundwork for its fight against FDI in retail in India. The other is political opportunism, as in West Bengal and UP, where opposition parties arranged protests and attacks not on principle, but because an opportunity to undermine the governing party presented itself. End comment.

¶17. (U) Visit New Delhi's Classified Website:
<http://www.state.sgov.gov/p/sa/newdelhi/>.

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